CHAPTER SEVEN

CONCLUSION.

In this chapter an attempt is made to summarise the conclusions that have emerged from a comprehensive survey of joint-stock banking in India and some recommendations are made in the light of those conclusions in order to make the banking system more useful and effective in the various spheres of the economy where there is scope for joint-stock banks to play their part.

Especially in the light of recent events the importance of joint-stock banks has increased in India as a source of credit. The War (1939-46) had a profound effect on the banking system in India. Fortunately India escaped damage and destruction due to aerial bombardment which occurred in other belligerent countries. The Indian banks therefore enjoyed comparative peace and developed in various directions taking advantage of the prevailing conditions of boom brought about by the War. The deposits of banks of all classes increased by great strides due to the increase in economic activity. The enormous resources created by the War by way of deposits gave a tremendous fillip to the banks and some of them even ventured to establish connections in foreign countries to take part in financing India's foreign trade. This is a good augury for the Indian joint-stock banks that they are making a beginning in a field which had previously been
largely unexplored by them. The increase of deposits and the large amount of cheques cleared during the War reflects the development of banking habit in the country. The cash position of the Indian joint-stock banks during the War was very sound and the banks maintained a high level of liquidity by holding a large proportion of Investments. The sound position of the banks encouraged the bankers to depart from their traditional principles of not lending for medium and short-term purposes. This is a welcome sign that banks are breaking away from their conservative policies as regards industry. Hence it may be hoped that in future banks may be induced to finance industry within safe bounds. Eventhough the Reserve Bank of India helped some banks in their difficulties, yet on the whole, the Indian joint-stock banks were stable and self-reliant during the War owing to the prevailing easy money conditions. The fall in advances and discounts in the first half of the War was made up by a rise in investments in government and other securities and thus in spite of the fall in advances and discounts the earnings of the banks did not suffer because any loss in revenue was made up by the increase in investments. The capital and reserves of banks increased during the War but their percentage to total deposits declined due to the rise in deposits out of proportion to the capital and reserves. This shows that the working capital of banks in India was composed of borrowed capital more than owned capital. Thus India was approaching in this respect other advanced countries of the world like England where percentage of capital and reserves to total deposits is generally low.
indicating the advanced stage of development wherein banks depended more on the confidence of the public and their deposits rather than their owned capital. This may be an encouraging sign that India is taking her place with other advanced countries of the World in banking but until Indian banking is perfected capital and reserves must bear a high percentage to total deposits.

The investments of the Indian joint-stock banks in Government securities indicates the measure of their contribution towards the finance of the struggle. In this regard, the Imperial Bank of India led the others. The trend of its investments to deposits was on the increase during the War and so also that of the other Scheduled banks but the non-scheduled banks did not show a high percentage of investments. However, on the whole, the Indian joint-stock banks financed the War to a large extent.

There was a remarkable expansion of banking in India during the War. Branch banking of all classes of banks, scheduled and non-scheduled, made considerable progress. Though several defects were detected in the banks they were checked and remedied by temporary measures. On the whole Indian banking developed and emerged from the War stronger and greater than ever before. In view of this they can play an important part in providing credit for other activities besides trade such as agriculture, industry and foreign trade.

Even in the pre-War years, banking in India was developing fairly rapidly and along sound lines. The period 1931 - 1938 was one of economic recovery from the Depression
of 1929 - 1932 and the trade cycle was moving upwards. The growth of banks in India during this period was quite good, compared to the previous years. The non-scheduled banks or the smaller banks excelled the bigger ones in their expansion showing that the growth of small banks has great possibilities in India and they should be encouraged. They can play an important part in developing a system of unit banking in the country. The capital and reserves of banks during this period grew with the expansion of banks. Both the A and B classes were building up their reserves and increasing their strength. But the small banks, C and D classes were backward in their reserves and hence weak and some of them perished during the War, while the capital and reserve position of the leading Indian joint-stock banks was sound. In encouraging the growth and development of small banks in the country they should be made to pay greater attention to their reserves and capital resources like the big banks. Otherwise they cannot survive.

In the period 1931 - 1938 the deposits of banks grew up, indicating the development of banking habit among the public. The large percentage of time deposits to total deposits shows that more and more people were taking to banking and invested their savings instead of idly hoarding them. This is also borne out by the expanding amount of cheques cleared in the clearing houses every year. With the growth of deposits the cash ratio of banks rose in this period. In this respect India was higher than most other countries. Besides cash the Indian joint-stock banks invested a good proportion
of their funds in Government and other securities which were easily and quickly convertible into cash when necessary. Thus the position of the banks was perfectly safe and their assets were quite liquid. In keeping with the high economic activity of the period advances and discounts of banks followed an upward trend. Taken together with rising trend of deposits, the rise in advances and discounts reflects the flourishing state of business in this period. The trend of bills discounted alone in India showed a rising trend in some of the leading Indian joint-stock banks indicating the growth of bills. This is an encouraging sign for the bill market of the country. The smaller joint-stock banks also should discount bills and encourage their use thus helping the development of the bill market. With the cooperation of the Indian joint-stock banks an effective bill market can be build up in India. In this period branch expansion of the banks was also quite good. From 744 branches in 1931 of Scheduled banks, the number rose to 1566 in 1938. Thus in India both branch banking and unit banking should be carried on side by side, the former in cities and towns and the latter in villages. As seen above the smaller joint-stock banks can play an important part in developing unit bank:

Thus even prior to the War the progress of banking was quite good in India. It was developing along sound lines and when the War came it gave it considerable impetus and it naturally developed in all directions. Hitherto in India joint-stock banks have been very conservative in their attitud
to industrial finance. They have been very orthodox in their outlook and refused to lend for long-term purposes out of their short-term deposits from the public. In India there are no industrial banks as in other countries. The joint-stock banks in India are more or less specialised in commercial banking. At least in the future development of the country the Indian joint-stock banks ought to participate in industrial finance, following the example of Germany which represents well the Continental type of mixed banking. As in Germany if proper safeguards are taken it would be quite safe to finance industries. As in Germany if the Indian joint-stock banks disperse their risks widely and maintain secret reserves the risk of long term finance out of short term deposits will be reduced. Further if the deposits of joint-stock banks in India were safeguarded by insuring them, the banks could probably be induced to give long-term credit to industry out of their short term deposits. This may be possible by opening a deposit insurance corporation in India as in the United States. A corporation for insuring bank deposits is a special feature of the banking system in the USA. From 1907 - 1932 was a period of bank failure in American banking history. To arrest these crises, President Roosevelt established a Deposit Insurance Corporation in the United States by the banking Acts of 1933 and 1935. The first Act established a temporary fund and the second established the permanent fund of the Corporation. The Deposit Insurance Corporation is a government sponsored institution with 3 directors of whom one is the Comptroller of

0 The Industrial Finance Corporation was set up by the Government of India only a year back.
Currency, ex-officio. The two others are independent members appointed by the Government. The first capital stock of about 300 million dollars was contributed in equal parts by the Treasury and the Federal Reserve Banks. The working of the Corporation to the end of 1947 has disclosed such a large surplus that the Corporation has been authorised to repay the capital stock. The revenue of the Corporation is an assessment of 1/12th of 1% of the deposits of the insuring banks. During the period of the temporary fund, it was Rs. 1/4 of 1%. The Corporation insures only deposits which are 5000 dollars. Really 98% of the depositors are of this limit and the deposit insurance Corporation therefore provides comprehensive protection. The income of the Corporation for the period of 1938 - 1947 has been 785 million dollars from assessment and another 217 millions from interest on its funds.

The expenses and losses together come to only 79 million dollars whereas the income by way of interest of funds alone comes to 217 millions. Thus the Corporation has a surplus of 923 million dollars. At the end of 1947, the total of deposits insured by the Corporation reached the colossal figure of 154 billion dollars. This is in brief the working of the Deposit Insurance Corporation of the United States. A similar scheme should be introduced by the Government of India, to encourage banks to finance industries.

Similarly in the sphere of agriculture the joint-stock banks in India have played a minor role in providing the long-term finance of the industry. This would also be promoted ii
deposit insurance corporation is set up in India. But in the matter of agricultural finance the indigenous joint-stock banks, proposed above, should meet the needs of agriculture as far as possible since the joint-stock banks may not be able to give credit to industry as well as agriculture and at the same time finance foreign trade. The joint stock banks should confine themselves internal trade, industry and foreign trade and leave agriculture to the indigenous joint-stock banks and the cooperative banks. If they have surplus funds they should direct them towards agriculture. Or if some of the smaller banks among them cannot meet the needs of foreign trade and industry they may turn to trade and agriculture. Such banks should follow the recommendations of the Agricultural Credit Department of the Reserve Bank of India.

The history of the Exchange Banks in India shows that they have always enjoyed a monopoly of the foreign exchange business. Besides the financing of foreign trade the exchange banks also do internal banking including every kind of banking business in competition with the other joint-stock banks of the country. By various methods they have obtained a firm footing in India. It is true they have been rendering invaluable service to India in financing her foreign trade in the absence of any Indian joint-stock banks fit to undertake this business. But their participation in internal banking of the country is causing considerable embarrassment to the Indian joint-stock banks. The exchange banks have steadily expanded ever since their inception in 1842.
From 3 in 1870 their number has grown to 15 in 1946 with a wide network of branches. The statistical evidence of their expansion seems to indicate that the A class banks and the B class banks work in close alliance. In the early days the exchange banks found a virgin field in India full of potentialities and they expanded and developed their business. They work on sound lines. They have large capital resources and they maintain their liquidity at a high level. The exchange banks do not publish information about their activities. Like the other joint-stock banks they should publish their balance sheets periodically. The membership of the clearing houses in India has grown lately which indicates that the complaint against them that they excluded the Indian joint-stock banks from the clearing houses seems to be no longer true. In view of the promising future for India in international trade and the growth of foreign exchange business, the Indian joint-stock banks should take their place along with the exchange banks and participate in foreign exchange business. The Indian joint-stock banks should establish connections abroad with their increased strength and stability and resources acquired in the War. The exchange banks should withdraw from internal banking and the public should cooperate with the joint-stock banks in carrying out their plan.

Among the joint-stock banks in India the Imperial Bank of India has played an outstanding part in the banking development of the country. The Imperial Bank of India was the result of a long process of evolution. India was in
need of a central bank. After World War I due to several reasons the Presidency banks were amalgamated to form the Imperial Bank of India in 1921 under a special charter. The history of the Imperial Bank can be divided into two periods: From 1921 to 1934 it acted as a central bank as well as a commercial bank. Such an institution was not peculiar to India alone. A similar bank existed in France. In India due to several reasons it did not work as successfully as in France. Hence from 1934 the Reserve Bank of India came and took over its central banking functions leaving it to work as a commercial bank only. Due to its peculiar nature and the privileges enjoyed by it as the government banker the Imperial Bank was in an advantageous position to compete with the other joint-stock banks. Due to its enormous resources the Bank pays low deposit rates and none at all on its current accounts. And it charges on its loans less than other banks. And yet the bank has earned good profits, indeed the highest in India barring the Indian Bank. Thus as a result of various favourable factors the bank has been offering uneconomic competition to other banks. Though from the point of view of the public the cheap credit provided by the bank may be of advantage yet it has been very annoying to other joint-stock banks. Taken absolutely the net profits of the Imperial Bank has been declining down the years. This is due to a decline in gross profits while the expenditure of the Bank has remained more or less constant. The declining profits may be explained by the unattractive deposit rates of the Imperial Bank, non-payment of interest on its current
accounts and the uneconomic maintenance of some of its branches. To remedy this defect the bank should revise its policy and raise its deposit rates. It should cut down its expenditure by closing its uneconomic branches and replacing its European staff by Indian staff as the latter would be cheaper. It has been suggested in some quarters that three head offices are unnecessary for it and two of them should be closed. But in view of the proposed nationalisation of the bank it may be necessary to have all the head offices working. According to the Banking Bill the whole burden of controlling the credit system has been cast on the Reserve Bank of India. If the Imperial Bank should be nationalised it will have to share some of the burden and relieve the Reserve Bank to some extent. In that event the three head offices of the Imperial Bank will be essential. Other means of raising its revenue should be explored. The Imperial Bank can very well participate in foreign exchange business which is considered to be highly profitable. The Imperial Bank of India ought to lead others in fact in this matter. With its age-long experience and enormous resources it should forthwith enter the field and compete with the exchange banks. Again the Imperial Bank should also participate in industrial finance and take to company promotion as the German joint-stock banks. Apart from the consideration of the bank's own profits this is vitally necessary from the viewpoint of the larger interest of the country. Hence if the Bank should fail to achieve these objects with its present resources, it should be nationalised as proposed and the funds of the State should be
placed at its disposal to carry out its new policy with regard to industry and the finance of foreign trade. Once it leads the way the other joint-stock banks in the country may follow. Another factor which has to be considered in the question of the nationalisation of the Imperial Bank is whether it is run quite efficiently. This question can be answered only by the Reserve Bank of India and if the Imperial Bank is found wanting in this it may be good to nationalise it. The efficiency of the bank can be judged by examining its income and expenditure. If either of them is found to be excessively high it means that there is waste somewhere in the system and the bank is not providing loanable funds to the public as cheaply and efficiently as it ought to do. If the fact of such waste can be established nationalisation of the Imperial Bank is to be advocated. As already mentioned with the coming into force of the new Banking Act the Reserve Bank will be burdened with the management of the whole system and it may not be able to cope up with such a colossal task and hence it may be considerably reduced if the Imperial Bank is also nationalised and made to share its work. Thus if the Imperial Bank is also nationalised like the Reserve Bank of India they may enter into a kind of partnership in carrying out the duties of enforcing the acts of the new Bill among the banks and thus helping to improve the banking system of the country. If the Imperial Bank remains in private hands, even though it may act as the agent of the Reserve Bank their alliance cannot be so effective as in the event of the Imperial Bank being nationalised and taken over by the State.
But until it is nationalised the Imperial Bank of India Act should be amended and it should be made to work on the same footing as the other banks. It should cease to work under a special charter. The Imperial Bank has been acting as the sole agent of the Reserve Bank of India. As such it performs certain functions for the Central Government and the Provincial Governments and the Railway Board and in return gets a commission. Apart from the remuneration the privilege of acting as the agent of the Reserve Bank has greatly enhanced the prestige of the bank. This special favour shown to the Imperial Bank of India is rather unfair to the other joint-stock banks. Some of the leading Scheduled banks should get a share in these special privileges. Thus the complaint of uneconomic competition will be removed gradually.

One chief lacuna in the banking system of India is the want of a good bill market and the lack of well-developed bills. This gap can be filled up effectively with the help of the indigenous bankers and money-lenders. In fact the indigenous bankers are indispensable for the development of joint-stock banking in India from many points of view. A clean sweep of the indigenous bankers despite their many defects is neither practicable nor desirable. On the contrary they should be reformed and brought under the organised banking system of the country. Indigenous bankers are highly developed in their own sphere of activity and provide a large part of rural credit in India for agriculture, small industries and internal trade. Compared to them the part played by the
cooperative banks and the Indian joint-stock banks is quite insignificant. The importance of indigenous bankers in the Indian rural economy is significant. The indigenous bankers should be brought closer to the organised banking in the country by strengthening the bonds between them and the joint-stock banks and the Reserve Bank of India. To do so the bill market in India must be developed. In other countries like the United States and England the banking system is so well knit together largely due to a well-developed bill market. The following plan is suggested for the reorganisation of the indigenous bankers and the development of the bill market in India: Since the methods used by the indigenous bankers are very much akin to the methods of modern banking and the principle elements of banking are to be found in them, the indigenous bankers can be modernised without much difficulty. Hence the indigenous bankers should be organised without much difficulty. Hence the indigenous bankers should be organised into joint-stock banks called the indigenous joint-stock banks. They will receive deposits, give advances and discount hundis like the Indian joint-stock banks. Thus they will form a sort of unit banks and introduce the principles of joint-stock banking in the backward regions of the country. They will discount more and more hundis and popularise them in the finance of agricultural crops, small industries and internal trade, the hundis in all cases being drawn against commodities. Hitherto the hundis in India have not been fully developed. Their advantages have been realised only partially. They have been used more often to borrow money rather than as a bill of exchange in the real sense of the term. Their use must be fully realised and exploited. The
indigenous joint-stock banks with the knowledge at their command regarding their clients and customers can very well act as acceptance houses and guarantee bills as the shroffs have been doing. The indigenous paper thus encourage and created by them will be rediscounted by the Indian joint-stock banks and the Reserve Bank of India thereby linking up the various parts of the banking system. The smaller indigenous bankers and money lenders will play the role of bill-brokers and running brokers of the discount market. Statistical and other information of indigenous bankers has been very meagre in the past. A commission should be set up in each province to carry out an extensive survey of indigenous bankers in view of the immense importance of the problem. So far only some stray measures have been taken by the Reserve Bank to improve the bills and encourage their use, but they are totally inadequate and just touch the fringe of the problem. The Reserve Bank of India with the great support of the State behind it as a nationalised institution should undertake a thorough examination of the question and reorganise the indigenous bankers and bring them under its control.
A NOTE ON THE BANKING COMPANIES ACT
1949. **

The Banking Companies Act of 1949 is an important step in the reorganisation of Indian banking. From a study of Joint-stock banking in this country we have noted several defects in the system. The new act seeks to rectify some of them. But in some respects it is found wanting. For instance, a very vital aspect of the Indian Banking problem is neglected by the Act as it fails to deal with the Indegenous bankers and money lenders whose significance has already been well stressed in this thesis.

In the past, many of the bank failures in India arose from an indiscriminate combination of banking and non-banking business. The new Act defines the forms of business in which banking companies may rightfully engage and prohibits them from trading and in other ways restricts certain of their activities (Sections 6 - 10).

To strengthen the position of banks and consolidate them, minimum requirements of paid-up capital and reserves, regulation of paid-up capital, subscribed capital and authorise capital are laid down. Every banking company is required to keep a reserve fund equal to at least its paid up capital and to maintain cash reserves for the sake of liquidity. (See Sections 11 - 18)

** Please see Appendix "D".
The Reserve Bank of India is vested with very wide powers to exercise not only a general control over the whole banking system but also to control the day-to-day operations of banks and direct their lending policies. This is a stupendous task for a central bank to undertake. To carry out its duties fully under the present Act, the Reserve Bank will need a colossal organisation and an immense staff well-trained in banking methods which may not be available immediately. Moreover it seems unnecessary to cause the Reserve Bank to interfere with the internal working of individual banks. Besides being impracticable, this measure is not likely to be popular with the banks (see section 21).

Section 22 lays down compulsory licencing of banks. This is very essential in India in order to promote the development of native institutions and check uneconomic competition from foreign banks. In dealing with the Exchange Banks it has been pointed out how there is widespread grievance against them due to their uneconomic competition with the Indian Institutions for the internal trade of the land. The licencing of banks will meet this complaint.

Section 23 is an important step in the proper organisation of branch-banking in the country. We have already noted above the maldistribution of bank branches in the country resulting in the failure of some branches to attract business. By restricting indiscriminate extension of branches in the wrong places, the Reserve Bank can greatly help the banking system and put it on sound lines.

Section 27 provides for the proper dissemination and publication of information regarding the operations of
banks and their position from time to time which is a very vital factor in retaining the confidence of the public.

To prevent malpractices in banks, it is also provided that the balance sheets of banks should be properly audited by authorised auditors and sent to the Registrar of Joint-stock Companies. To maintain the discipline of banks the Reserve Bank is further empowered to undertake the inspection of banks when it thinks necessary. Apart from the powers enjoyed by the Reserve Bank over the whole banking system, it owes it to them to render assistance whenever they need it and offer its advice when they seek it. (See sections 28 - 36).

On the whole, the new Act goes a long way in improving the banking system in India, but its chief failing appears to be that it has neglected the Indeginous Bankers completely. Having regard to the vital importance of the Indeginous Bankers to the country today and the role they have got to play in building an effective discount market, this negligence must be rectified without delay.

Another useful feature of the Act is that some of the provision are applicable to the Imperial Bank of India without prejudice to the Imperial Bank of India Act 1920.